SOUTH CAROLINA
STATE ETHICS COMMISSION

COLUMBIA, SOUTH CAROLINA

STATE AUDITOR'S REPORT

JUNE 30, 1999

CONTENTS

INDEPENDENT ACCOUNTANT'S REPORT ON APPLYING AGREED-UPON PROCEDURES

June 23, 2000

The Honorable James H. Hodges, Governor
and
Members of the Commission
South Carolina State Ethics Commission
Columbia, South Carolina

We have performed the procedures described below, which were agreed to by the governing body and management of the South Carolina State Ethics Commission, solely to assist you in evaluating the performance of the South Carolina State Ethics Commission for the fiscal year ended June 30, 1999, in the areas addressed. This engagement to apply agreed-upon procedures was performed in accordance with standards established by the American Institute of Certified Public Accountants. The sufficiency of the procedures is solely the responsibility of the specified users of the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose. The procedures and the associated findings are as follows:

1. We tested selected recorded receipts to determine if these receipts were properly described and classified in the accounting records and internal controls over the tested receipt transactions were adequate. We also tested selected recorded receipts to determine if these receipts were recorded in the proper fiscal year. We compared amounts recorded in the general ledger and subsidiary ledgers to those in the State's accounting system (STARS) as reflected on the Comptroller General's reports to determine if recorded revenues were in agreement. We made inquiries and performed substantive procedures to determine if revenue collection and retention or remittance were supported by law. We compared current year recorded revenues from sources other than State General Fund appropriations to those of the prior year and, using estimations and other procedures, tested the reasonableness of collected and recorded amounts by revenue account. We also tested the accountability and security over permits, licenses, and other documents issued for money. The individual transactions selected for testing were chosen randomly. We found no exceptions as a result of the procedures.

2. We tested selected recorded non-payroll disbursements to determine if these disbursements were properly described and classified in the accounting records, were bona fide disbursements of the Commission, and were paid in conformity with State laws and regulations and if internal controls over the tested disbursement transactions were adequate. We also tested selected recorded non-payroll disbursements to determine if these disbursements were recorded in the proper fiscal year. We compared amounts recorded in the general ledger and subsidiary ledgers to those in various STARS reports to determine if recorded expenditures were in agreement. We compared current year expenditures to those of the prior year to determine the reasonableness of amounts paid and recorded by expenditure account. The individual transactions selected for testing were chosen randomly. We found no exceptions as a result of the procedures.

3. We tested selected recorded payroll disbursements to determine if the tested payroll transactions were properly described, classified, and distributed in the accounting records; persons on the payroll were bona fide employees; payroll transactions, including employee payroll deductions, were properly authorized and were in accordance with existing legal requirements; and internal controls over the tested payroll transactions were adequate. We tested selected payroll vouchers to determine if the vouchers were properly approved and if the gross payroll agreed to amounts recorded in the general ledger and in STARS. We also tested payroll transactions for new employees and those who terminated employment to determine if internal controls over these transactions were adequate. We compared amounts recorded in the general ledger and subsidiary ledgers to those in various STARS reports to determine if recorded payroll and fringe benefit expenditures were in agreement. We performed other procedures such as comparing current year recorded payroll expenditures to those of the prior year; comparing the percentage change in recorded personal service expenditures to the percentage change in employer contributions; and computing the percentage distribution of recorded fringe benefit expenditures by fund source and comparing the computed distribution to the actual distribution of recorded payroll expenditures by fund source to determine if recorded payroll and fringe benefit expenditures were reasonable by expenditure account. The individual transactions selected for testing were chosen randomly. Our finding as a result of these procedures is presented in Earmarked Subfund Expenditures in the Accountant's Comments section of this report.

4. We tested all recorded journal entries and interagency appropriation transfers to determine if these transactions were properly described and classified in the accounting records; they agreed with the supporting documentation, were adequately documented and explained, were properly approved, and were mathematically correct; and the internal controls over these transactions were adequate. Our finding as a result of these procedures is presented in Earmarked Subfund Expenditures in the Accountant's Comments section of this report.

5. We tested selected entries and monthly totals in the subsidiary records of the Commission to determine if the amounts were mathematically accurate; the numerical sequences of selected document series were complete; the selected monthly totals were accurately posted to the general ledger; and the internal controls over the tested transactions were adequate. The transactions selected for testing were chosen randomly. We found no exceptions as a result of the procedures.

6. We obtained all monthly reconciliations prepared by the Commission for the year ended June 30, 1999, and tested selected reconciliations of balances in the Commission's accounting records to those in STARS as reflected on the Comptroller General's reports to determine if they were accurate and complete. For the selected reconciliations, we recalculated the amounts, agreed the applicable amounts to the Commission's general ledger, agreed the applicable amounts to the STARS reports, determined if reconciling differences were adequately explained and properly resolved, and determined if necessary adjusting entries were made in the Commission's accounting records and/or in STARS. The reconciliations selected for testing were chosen randomly. Our finding as a result of these procedures is presented in Reconciliations in the Accountant's Comments section of this report.

7. We tested the Commission's compliance with all applicable financial provisions of the South Carolina Code of Laws, Appropriation Act, and other laws, rules, and regulations for fiscal year 1999. We found no exceptions as a result of the procedures.

8. We reviewed the status of the deficiencies described in the findings reported in the Accountant's Comments section of the State Auditor's Report on the Commission resulting from our engagement for the fiscal year ended June 30, 1998, to determine if adequate corrective action has been taken. Our findings as a result of these procedures are presented in Section C – Status of Prior Findings in the Accountant's Comments section of this report.

9. We obtained copies of all closing packages as of and for the year ended June 30, 1999, prepared by the Commission and submitted to the State Comptroller General. We reviewed them to determine if they were prepared in accordance with the Comptroller General's GAAP Closing Procedures Manual requirements; if the amounts were reasonable; and if they agreed with the supporting workpapers and accounting records. Our finding as a result of these procedures is presented in GAAP Closing Packages in the Accountant's Comments section of this report.

We were not engaged to, and did not, perform an audit, the objective of which would be the expression of an opinion on the specified areas, accounts, or items. Further, we were not engaged to express an opinion on the effectiveness of the internal control over financial reporting. Accordingly, we do not express such opinions. Had we performed additional procedures or had we conducted an audit or review of the Commission's financial statements or any part thereof, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the Governor and of the governing body and management of the South Carolina State Ethics Commission and is not intended to be and should not be used by anyone other than these specified parties.

Thomas L. Wagner, Jr., CPA
State Auditor

ACCOUNTANT'S COMMENTS

SECTION A - MATERIAL WEAKNESSES AND/OR VIOLATIONS OF STATE LAWS, RULES OR REGULATIONS

The procedures agreed to by the agency require that we plan and perform the engagement to obtain reasonable assurance about whether noncompliance with the requirements of State Laws, Rules, or Regulations occurred and whether internal accounting controls over certain transactions were adequate. Management of the entity is responsible for establishing and maintaining internal controls. A material weakness is a condition in which the design or operation of one or more of the specific internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Therefore, the presence of a material weakness or violation will preclude management from asserting that the entity has effective internal controls.

The conditions described in this section have been identified as material weaknesses or violations of State Laws, Rules, or Regulations.

GAAP CLOSING PACKAGES

Introduction

The State Comptroller General's Office obtains certain generally accepted accounting principles (GAAP) data for the State's financial statements from agency-prepared closing packages because the State's accounting system (STARS) is on the budgetary basis. We determined that the Commission misstated two of its fiscal year-end 1999 closing packages.

To accurately report the Commission's and the State's assets, liabilities, and current year operations, the GAAP closing packages must be complete and accurate. Furthermore, Section 1.8 of the Comptroller General's GAAP Closing Procedures Manual (GAAP Manual) states that "Each agency's executive director and finance director are responsible for submitting . . . closing package forms . . . that are: •Accurate and completed in accordance with instructions. •Complete. •Timely." Also, this section of the GAAP Manual requires an effective review of each completed closing package and lists the minimum review steps to be performed. Section 1.9 of the GAAP Manual provides that "Agencies should keep working papers to support each amount they enter on each closing package form."

The following outlines the errors we noted on certain 1999 closing packages.

Fixed Assets

Section 3.8 of the GAAP Manual requires that each agency with general fixed assets submit a general fixed assets summary form to the Comptroller General's Office each fiscal year. On this form, the agency is to report by fixed asset category beginning balance, net corrections to prior year balances, additions, retirements, and the ending balance for the fiscal year. On the Commission's summary form for fiscal year 1999, net corrections to the prior year balance did not agree with the supporting documentation. The amount reported on the summary form was $45,019, and the amount reported on the Inventory Deletions Worksheet was $44,613, a difference of $406. We were told that the Commission's staff prepares worksheets to support the amounts reported on the Inventory Deletions Worksheet. However, they did not retain the worksheets used to compute the amount reported. We also noted that the Commission reported no retirements on the general fixed assets summary form even though according to the Comptroller General's Statement of Estimated and Actual Revenue, the Commission collected and retained $195 for the sale of data processing and office equipment. Therefore, it appears that a portion of the amount reported on the summary form as net corrections to prior year balances should have been classified as retirements.

Section 3.10 of the GAAP Manual requires that each agency with general fixed asset additions submit a fixed asset additions reconciliation form. On this form, the agency is to report total fixed asset expenditures on STARS for the fiscal year (STARS object codes 06xx and 07xx, FM 01 - FM 13), fixed asset additions for the fiscal year that did not result in STARS 06xx and 07xx object code expenditures during the year, and expenditures charged to STARS object codes 06xx and 07xx during the fiscal year that did not represent additions to fixed assets in the current fiscal year. The Commission reported $431 on the reconciliation form as 06xx and 07xx expenditures not meeting the Commission's capitalization criteria (items with a useful life of more than one year costing in excess of $250.) The amount reported could not be agreed to supporting documentation because the documentation was not retained. Furthermore, the Commission's staff could not explain how they determined this amount.

<u>Compensated Absences</u>

Section 3.17 of the GAAP Manual requires every agency with employees who earn annual leave to complete the Compensated Absences Closing Package. On the compensated absences summary form, the agency is to report as a liability the accumulated unused annual leave and holiday and overtime compensatory time earned by employees who are employed at the agency on June 30. The Commission reported $33,444 as accrued annual leave on the Compensated Absences Form. This amount included $10,256 for an employee who retired on

June 30, 1999. The GAAP Manual states that “Agencies will exclude from the Compensated Absences Summary Form (GAAP Form 3.17.1) any amounts associated with personnel who terminated their State employment during June, including June retirees. (The Comptroller General’s Office will include the liabilities for terminated employees, including June retirees, in its payroll accrual computations.)” Therefore, the compensated absences liability was overstated by $10,256.

Recommendations

We recommend that the Commission implement procedures to ensure that all closing packages contain accurate and complete information in accordance with the GAAP Manual requirements and instructions. We recommend that the Commission design and follow procedures to ensure that an appropriate supervisor other than the preparer determine the accuracy and adequacy of documentation prepared, retained, and cross-referenced to support each closing package response (monetary and other); determine the reasonableness of each closing package response; agree each response to the accounting and other source records; and perform the independent comparison of amounts used in calculations to the source records, independent verification of the computations, and independent review by someone knowledgeable of GAAP and familiar with the GAAP Manual. When the Commission’s employees who are responsible for preparing and reviewing closing package forms do not understand the forms and/or the instructions, they should contact the Office of the Comptroller General for assistance.

EARMARKED SUBFUND EXPENDITURES

During our engagement, we were told that the Commission paid 51% of one employee's salary from State funds and the other 49% from earmarked funds. However, the individual's Employee Profile indicates the salary was approved to be paid 40% from State funds and 60% from "other" funds. We were also told that the Commission charges 100% of the salary to State funds at the beginning of the year and 100% of the salary to earmarked funds during the latter part of the year. We noted during our payroll tests that 100% of the employee's semimonthly pay for the February 16, 1999 and April 30, 1999, pay dates were charged to State Appropriated funds. We also noted that the Commission paid the same amount of the employee's salary ($13,608) from earmarked funds during fiscal years 1999, 1998, 1997. The Commission's employees did not perform an analysis to determine if the amount allocated to "other" funds should be revised as the employee received annual pay increases. Furthermore, the Commission maintained inadequate documentation to demonstrate how it calculated the allocations of the employee's fringe benefits and that it properly charged a proportionate share of fringe benefits to each subfund.

The State Budget and Control Board Office of Human Resources Personnel Information Reporting System Procedures Manual (page 1) states, in part, the following:

> The Employee Profile is the primary form used for reporting and maintaining statewide position and employee information . . . All data reported on the Employee Profile is maintained on a master personnel file and is used for statistical analysis, projection of salary data for budget purposes and generation of various management reports. Therefore, it is critical that all information be reported on an accurate and timely basis.

Proviso 63G.1. of Part 1B of the 1999 Appropriation Act states " . . . that any agency . . . whose operations are covered by funds from other than General Fund Appropriations shall pay from such other sources a proportionate share of the employer costs of . . . and any other employer contribution provided by the State for the agency's employees." Proviso 63C.10.

states that “Appropriated funds may be used for compensation increases for classified and unclassified employees and agency heads only in the same ratio that the employee’s base salary is paid from appropriated sources.”

The weakness identified in paragraph one was also noted in Earmarked Subfund Accounting in the Accountant’s Comments section of the State Auditor’s Report on the Commission for the fiscal year ended June 30, 1998, and dated July 12, 1999. The prior report also noted that the Commission maintained inadequate documentation to demonstrate how it calculated the allocations of fringe benefits to each subfund. Also, it improperly charged payroll costs to the general fund because it did not have budget remaining in the earmarked subfund to pay an employee in accordance with the fund source authorized on the employee’s profile form. The Commission recorded these fiscal year 1998 transactions in its general ledger with journal entries. These journal entries did not include evidence of independent review and approval by someone other than the preparer before being recorded in the accounting records. The prior report recommended that when establishing labor costs, the Commission estimate sales and other revenues for the fiscal year to ensure that it establishes the proper earmarked personal services and employer contributions budgets and the proper percentages by payroll funding sources (general and earmarked funds) on the employee profile forms. Furthermore, the report recommended the Commission monitor its budgets by subfund and object code on an ongoing basis. When actual revenues and expenditures by funding source differ significantly from estimates, the Commission’s budget and employee profile information should be timely updated during the fiscal year.

We again recommend the Commission ensure that the proper amounts of personal services and proportionate amounts of employer contributions are recorded in the correct subfunds. The Commission should determine the amount of earmarked subfund salary and fringe costs improperly charged to the general fund for fiscal years 1999 and 1998 and process a prior year expenditure refund remitting the monies to the State General Fund in accordance with Section 11-9-125 of the South Carolina Code of Laws, as amended. The Commission should implement procedures to ensure that each journal entry and other accounting documents include proper supporting documentation of the reason for the transaction and the bases for the calculations of the amounts. In addition, the journal entries should be properly reviewed by someone other than the preparer before they are recorded in the accounting records.

SECTION B – OTHER WEAKNESS NOT CONSIDERED MATERIAL

The condition described in this section has been identified as a weakness subject to correction or improvement but not considered a material weakness or violation of State Laws, Rules, or Regulations.

RECONCILIATIONS

Section 2.1.7.20 of the Comptroller General's Policies and Procedures Manual (STARS Manual) requires agencies to perform reconciliations of revenues, expenditures, and ending cash balances at least monthly on a timely basis to ensure adequate error detection and correction to satisfy audit requirements. Such reconciliations also provide assurance that transactions are processed correctly both in the Commission's accounting records and in the Statewide Accounting and Reporting System (STARS).

STARS reports expenditures by subfund. At June 30, 1999, the Commission had four unexplained expenditure reconciling items ($142.64, $75.64, $55.86, and $300.00) in both the general and earmarked subfunds between its accounting records and STARS. The Commission charged the first three unexplained reconciling items to the incorrect subfund on its books. The remaining unexplained reconciling item, a journal voucher, was prepared to correct the subfund on a disbursement voucher that did not need to be corrected. Agency personnel did not detect the errors because the Commission reconciles to STARS by total expenditures instead of expenditures by subfund. Monthly expenditure reconciliations by subfund would have detected these errors.

At June 30, 1999, the Commission had an unexplained revenue reconciling item ($1,309.00) in Subfund 2837. We were told that the reconciling item may have occurred because funds received from the South Carolina Department of Revenue may have been recorded by the Comptroller General in fiscal month 13 and not recorded in the Commission's accounting records.

In addition, we noted that the Commission does not maintain or reconcile cash accounts. Consequently, we were unable to reconcile balances in the Commission's books to the STARS Cash Status Report. Monthly reconciliations of the Commission's cash balances would have detected the effects of the expenditure and revenue recording errors described in paragraphs two and three. We were told that cash accounts were established in October 1999 and the Commission prepared reconciliations of ending cash balances during fiscal year 2000.

We recommend that the Commission implement procedures to ensure that it performs all required reconciliations of revenues, expenditures, and ending cash balances in the frequency and manner prescribed in the STARS Manual. The revenue and expenditure reconciliations should be at the subfund and object code level of detail.

SECTION C - STATUS OF PRIOR FINDINGS

During the current engagement, we reviewed the status of corrective action taken on each of the findings reported in the Accountant's Comments section of the State Auditor's Report on the South Carolina State Ethics Commission for the fiscal year ended June 30, 1998, and dated July 12, 1999. We determined that the Commission has taken adequate corrective action on each of the findings except for portions of Reconciliations, Closing Packages – Fixed Assets, and Earmarked Subfund Accounting. In response to our inquiries, we were told that the Commission has developed and implemented procedures to correct the weaknesses reported in the prior year. However, because some of the procedures were implemented after June 30, 1999, we did not perform tests to determine if the new procedures are operating effectively. Therefore, we have included similar comments in Section A – Material Weaknesses and/or Violations of State Laws, Rules, or Regulations in the Accountant's Comments section of this report.

MANAGEMENT’S RESPONSE

State of South Carolina
State Ethics Commission

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HERBERT R. HAYDEN, JR.
EXECUTIVE DIRECTOR

October 5, 2000

Mr. Thomas L. Wagner, Jr.
State Auditor
1401 Main Street Suite 1200
Columbia, South Carolina 29201

Dear Mr. Wagner:

We have received the preliminary draft of the Audit Report for the State Ethics Commission for the fiscal year ended June 30, 1999. In reviewing this report, we offer the following comments:

The Commission will comply with Sections 3.8, 3.10 and 3.17 of the GAAP Manual for reporting the proper requirements.

As stated in Fiscal Year 1998 report, the Commission will review its fixed asset program to determine the appropriate level of reporting. Changes to the inventory and appropriate asset closing packages have been made. These changes will be reflected in Fiscal Year 2000.

The Commission will report its compensated absences as required by GAAP.

2. The Commission is cited for the handling of earmarked funds transactions. As stated in Fiscal Year 1998 Report, effective Fiscal Year 2001, we will not pay a portion of employee salary with earmarked funds. Earmarked funds will be used only for office operations. The Commission will maintain documentation of the use of all earmarked funds from all sources.

Also, as you have requested, attached is a copy of the current Commission members and their mailing addresses.

The State Ethics Commission authorizes the release of this Audit Report.

Respectfully Submitted

Herbert R. Hayden, Jr
Executive Director

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